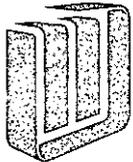


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METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

Baron E. Doff
EXECUTIVE SECRETARY

March 6, 1992

To: Board of Directors (Engineering and Operations Committee--Action)
(Water Problems Committee--Action)
(Finance and Insurance Committee--Action)
From: General Manager
Subject: Acquisition of Options from the 1992 Drought Emergency Water Bank

Report

In February, your Board authorized the General Manager to negotiate for substantial amounts of water from a 1992 Drought Emergency Water Bank (Bank) or other sources, including up to 200,000 acre-feet (AF) of base supplies and options for additional supplies. Since that time, conditions have changed considerably. Precipitation during February and early March make it likely that the State will increase allocations of water from the State Water Project. Moreover, because of unusually wet conditions combined with continued rationing in Southern California, Metropolitan's water sales have been unusually low so far this year. Generally, as water supply conditions improve, it is likely that many potential Bank participants will reduce or eliminate their requests for Bank water during 1992. In Southern California, however, the possibility of needing additional supplies from the 1992 Bank or other sources remains, and staff has continued to take actions to secure additional supplies, if needed.

Because of these changing circumstances, Metropolitan should consider an alternative strategy for acquiring additional supplies. Instead of pursuing further the February authorization, it is recommended that Metropolitan negotiate and execute a Bank agreement allowing it to acquire 100,000 AF of option contracts for water that could be delivered as late as September at Metropolitan's discretion. Under the draft Bank agreement (Agreement), which is still under negotiation at the time of this writing, Bank participants may secure options for a nonrefundable upfront deposit of \$20 per acre-foot. Of this amount, \$5 will be retained by the Department of Water Resources (DWR) to cover administrative expenses and \$15 will be provided to sellers who execute contracts to provide water to Bank participants who seek additional supplies.

If the Bank participants exercise their options, sellers would be required to make water available at an agreed upon price. In some seller contracts, price may vary according to a mutually agreed to formula that would depend upon future conditions (for example, based on the value of the Sacramento

River Index at a particular date). Such a formula was used in a successful program with Yuba County Water Agency in 1990. DWR staff indicate that water may be available for Bank participants at a cost of around \$100 per acre-foot of water delivered to the Harvey O. Banks Delta Pumping Plant. The Agreement further provides that Bank participants could exercise all or a part of their options monthly until September. Upon exercising an option to receive water, the Bank participant would be required to pay the remainder of the cost for the water received. Final costs will depend on the price specified in the seller contracts, negotiated between DWR and sellers, cost for carriage water, and administration. At this time, it is estimated that if Metropolitan fully exercises its options for 100,000 AF, the additional cost would be approximately \$8 million.

Such options could be highly desirable for Metropolitan. Metropolitan could, in effect, acquire a 100,000 AF insurance policy for \$2 million that would help assure that reasonable water demands would be met during the remainder of the year. If a hot summer or other factors warrant exercising the options to avoid significant economic impacts, 100,000 AF of additional sales would be available, with a corresponding increase in net revenues. If conditions later in the year do not warrant exercising the options, the "insurance premium" of \$2 million would be lost, but in the meantime the Southern California economy would benefit from enhanced reliability and reduced risk.

Several key issues remain in the negotiation of a 1992 Bank Agreement. These include: (1) the definition of critical needs in urban areas; (2) the allocation of water between agricultural and urban uses; (3) continued access to lower cost water made available through initial purchases by DWR; and (4) the development of water to meet fish and wildlife critical needs. Metropolitan staff have recommended that urban critical needs be based on the existence of significant economic harm, comparable to the treatment of agriculture in the Agreement, and that the Agreement drop references to required rationing percentages in urban areas. There remains the concern that the critical-needs criteria could result in Bank supplies going solely to Central Valley agriculture while urban areas are forced to maintain economically harmful levels of rationing. With regards to fish and wildlife critical needs, one approach under serious consideration is to allocate ten percent of Bank supplies to fish and wildlife critical needs at no cost to the Department of Fish and Game. While this approach would modestly increase the melded rate for urban and agricultural Bank participants, it is consistent with provisions in state and federal water transfer legislation that has been supported in principle by Metropolitan. More importantly, such a provision would help assure that urban and agricultural participation in

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the Bank generates environmental benefits, and would increase assurances that the Agreement could withstand any California Environmental Quality Act (CEQA) challenges that might arise.

It is anticipated that the DWR, as lead agency, will find this proposed Agreement to be exempt from CEQA, for reasons including the emergency created by the risk of significant economic harm if water is not available.

Funding for the \$2 million deposit is available in the 1991-1992 annual budget appropriations for this purpose.

Attached for your information is the report prepared by the Department of Water Resources on the background and results of the 1991 Drought Emergency Water Bank, a highly successful program in which Metropolitan staff played an instrumental role.

Board Committee Assignments

This letter was referred for action to:

The Engineering and Operations Committee for action because of its authority to make recommendations regarding the storage and distribution of water, pursuant to Administrative Code Section 2431 (d);

The Water Problems Committee for information because of its authority to study, advise, and make recommendations with regard to policies, sources, and means of importing water required by the District, pursuant to Administrative Code Section 2481(a); and

The Finance and Insurance Committee because of its authority to study, advise, and make recommendations with regard to the authorization of appropriations pursuant to Administrative Code Section 2441(d).

Recommendation

ENGINEERING AND OPERATIONS, WATER PROBLEMS, AND FINANCE AND INSURANCE COMMITTEES FOR ACTION.

That your Board authorize the General Manager to execute an agreement in a form approved by the General Counsel to allow Metropolitan to participate in the 1992 Drought Emergency Water Bank and to deposit \$2 million pursuant to such agreement to secure options on 100,000 acre-feet of water.


for Carl Boronkay

THQ:as